BOMA | CACC
Ex. 10 (CORRECTED)

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISISON

Commonwealth Edison Company	:	
	:	
Petition for declaration of service currently provided under Rate 6L to 3 MW and greater customers as a competitive service pursuant to Section 16-113 of the Public Utilities Act and approval of related tariff amendments.	:	No. 02-0479

DIRECT TESTIMONY OF EDWARD C. BODMER
ON BEHALF OF BUILDING OWNERS AND MANAGERS
ASSOCIATION OF CHICAGO, AKZO NOBEL, AUX SABLE
LIQUID PRODUCTS, INC., GENERAL MILLS, INC. AND
THE METROPOLITAN CHICAGO HEALTHCARE COUNCIL

Corrected

TABLE OF CONTENTS

DIRECT TESTIMONY OF EDWARD C. BODMER

I.

<u>QUALIFICATIONS</u>

Q. Please state your name and business address.

A. My name is Edward C. Bodmer. My business address is 5951 Oakwood Dr. Lisle, Illinois, 60532.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Building Owners and Managers Association of Chicago ("BOMA") and the Chicago Area Customer Coalition ("CACC").

Q. Please summarize your educational background and professional experience.

A. I received a B.S. degree in Finance with highest honors from the University of Illinois in 1979 and an MBA degree with honors from the University of Chicago in 1986. My regulatory experience began with my employment on the Accounting and Finance Staff of the Illinois Commerce Commission ("Commission") and has encompassed numerous assignments on regulatory issues as a consultant. In a past position as a Vice President at the First National Bank of Chicago, I managed the credit analysis of energy loans, which included transactions with electric and gas utility companies. I also directed a number of energy-related financial advice projects for bank clients. I am an adjunct professor of economics at Lewis University and I have taught professional courses on financial modeling, economics and corporate finance in South America, Asia, Western Europe, Eastern Europe, the Middle East, Africa and in the U.S. For the past eleven years, I have developed a consulting practice in the electric utility industry which has involved assignments for financial institutions, utility companies, and government agencies. My projects have addressed a variety of topics, including industry re-structuring, forecasting, pricing, resource planning, and performance evaluation. I have testified before this Commission and others on a wide range of subjects, including cost-of-service and rate design.

Most recently, I have testified before this Commission on issues related to the restructuring of the Illinois retail electric market in proceedings related to setting delivery services tariff rates; permitting continued collection of nuclear decommissioning charges; and the unbundling of delivery services.

Q. Do you have experience with respect to rate design issues in Illinois?

A. Yes. I have a general familiarity with the utility companies in Illinois from my work on the Commission Staff in the 1980's. In the context of subsequent consulting assignments, I have analyzed rate design and cost-of-service issues related to Commonwealth Edison Company ("ComEd," "Edison" or "Company") tariffs on a number of occasions since 1990. Relevant projects included: testimony on cost of service and rate design in Commonwealth Edison's 1994 rate case; analysis on behalf of The Suburban Councils of Government with respect to implementation of the Infrastructure Maintenance Fee and the Municipal Utility Tax; development of analyses to support the City's franchise negotiations with Edison in 1990 and 1991; testimony on behalf of the Illinois Attorney General, the Cook County State's Attorney and the Governor of Illinois on costs and benefits of Edison's proposed spin-off of nuclear plants; analysis of electricity legislative options on behalf of the Local Government Electric Power Alliance (the Chicago Transit Authority ("CTA"), the Chicago School Board, the Chicago Park District, the Chicago City Colleges, and the City of Chicago); and direction of the City's efforts in the co-operative cost study activities required by the City/Edison franchise agreement. I have testified in utility proceedings in California, Indiana, Kansas, Michigan, Maine, Minnesota, and Connecticut, as well as in Illinois.

II.

PURPOSE OF TESTIMONY
<u>AND SUMMARY OF RECOMMENDATIONS</u>

Q. What is the purpose of your testimony in this case?

A. My testimony responds to Edison's petition and related supporting testimony to declare Rate 6L service competitive for customers who incur demands of more than 3 MW of power and energy ("petition.") I review Edison's proposal from an economic perspective and apply options pricing theory to my analysis.

Q. What is your recommendation to the Commission regarding its consideration of Edison's proposal?

A. The Commission should deny Edison's petition because of its failure to demonstrate that reasonably equivalent substitute service exists and is available in the competitive market at a comparable price. Due to the continuing imposition and collection of customer transition charges ("CTC's"), if the Commission were to approve Edison's proposal, it would provide Edison with financial windfalls at the expense of customers. For several reasons, not the least of which is to promote the development of the competitive market, the Commission should dismiss Edison's petition. In making this recommendation, I have focused on what I believe are the objectives of the transition to competitive markets – lower prices and better service through competition. That is, competition was the means to benefit customers, not an end in itself.

Q. Do you have any initial comments or observations regarding Edison's petition and related testimony?

A. Yes. At the time of preparation of this testimony, it is unclear what Edison is requesting the Commission declare competitive. It seems that Edison may be requesting that all of Rate 6L be declared competitive. However, Edison presented no evidence that there is any competitive provider of any of the components of Rate 6L other than the supply of electric power and energy. At other points in Edison's petition and testimony it appears that Edison is only requesting that the provision of electric power and energy through Rate 6L be declared competitive. But if this is the case, Edison does not explain how, if at all, it intends to provide the remainder of the services that are included in Rate 6L.

Q. How is your testimony organized?

A. My testimony is divided into two sections and includes four attachments. The first section of my testimony addresses Edison's assertion that its proposal promotes competition. The second section of my testimony then applies the statutory criteria that I understand to be the standard for Commission review in order for a service to be declared competitive. Specifically, my testimony analyzes:

(1) whether requiring customers to use replacement service arrangements that include paying market prices for generation, delivery services tariff rates for wires charges plus a transition charge is service that is a "reasonably equivalent substitute" for current services available from Rate 6L;

(2) whether such a substitute service is "reasonably available ... at a comparable price"; and

(3) whether Edison has lost money from providing service to Rate 6L customers while collecting the transition charge.

Q. Describe the attachments to your testimony.

A. The first attachment, Attachment A to my testimony is titled ***"The CTC, Options and Forward Contracts – Why Edison's Proposal Results in a Free Option for the Company and There is No Free Option for Customers."*** The analysis in this attachment uses examples of two customer bills to demonstrate how Edison's claim that it is providing a "free option" to customers is wrong. Attachment A includes a simple proof that, as a result of the CTC's, it is Edison who is receiving the free option, not customers.

The second attachment, Attachment B, is an excerpt from my testimony in the delivery services case, ICC Docket No. 01-0423. This attachment demonstrates how Edison is being more than fully protected from a financial perspective by the CTC and how the Company does not need additional financial protection through declaring Rate 6L to be a competitive service.

The third attachment, Attachment C, is an article summarizing Edison's recent financial performance. This attachment includes quotes from Edison executives boasting about the Company's second quarter financial results. The attachment provides further evidence that Edison does not need to increase customer prices to bolster its financial position.

The final attachment, Attachment D, is a record of my testimony in other cases.

Q. What are the conclusions of your analysis?

A. It is clear that if its petition were granted, Edison's profits would increase and Edison would reduce its risk exposure at the expense of affected customers. It is equally clear that Edison's petition meets none of the statutory criteria under the Public Utilities Act and its Petition should be summarily denied. In great part due to Edison's continuing ability to collect the CTC, the conclusions of my analysis are:

(1) There is no reasonably equivalent substitute for the services that Edison presently provides under the combination of Rate 6L;

(2) There is no competitive price at which alternate providers could offer the service at which Edison is providing Rate 6L; and

(3) The Commission does not need to declare Rate 6L service competitive in order to protect Edison's financial position.

In sum, due to the present structure of the Illinois retail electric market, if the Commission were to approve Edison's proposal, it would provide the Company with financial benefits at the direct expense of customers. The Commission should not sanction Edison's petition for financial windfalls or impose significant economic burdens on customers in the name of competition.

III.

DECLARING RATE 6L SERVICE(S) COMPETITIVE WOULD NOT PROMOTE THE DEVELOPMENT OF AN EFFECTIVELYCOMPETITIVE ELECTRICITY MARKET

A. BACKGROUND

Q. As a context for analysis of Edison's proposal, should the Commission presume a "zero sum" analysis, or should the Commission presume that economic efficiency can be created by approving Edison's Petition?

A. The Commission should use a "zero sum" or "zero sum game" analysis. In the current Illinois retail electric market, the CTC drives the economics of most customer decisions. If the result from eliminating Rate 6L as a tariff option is generally good for Edison and good for alternative suppliers, that result is probably bad for customers. Applying this framework, elimination of customer alternatives proposed by Edison would transfer economic resources from customers to the Company. Changing tariff options in the manner proposed by Edison does not cause customers to use electricity more efficiently nor does it cause suppliers to build power plants in a more productive manner. So long as Edison imposes the CTC on its customers, eliminating options for customers is, by definition, costly to them and beneficial to Edison. To the extent that market efficiency is not affected by tariff revisions, this case boils down to Edison's financial position, not market efficiency.

Q. Please list some of the services that are provided under Rate 6L that Edison has not demonstrated would be available from competitive suppliers.

A. Rate 6L service includes metering service, distribution service, transmission service and generation service. If a customer cannot take service under Rate 6L, the customer can also not cap exposure to increases in metering service rates, delivery services rates, transmission costs and market power prices. On the other hand, if the prices for any of these services fall, Edison simply increases the CTC. Therefore, Rate 6L offers an insurance policy with respect to the zero CTC floor for customers. This insurance policy is for increases in unbundled prices (metering, distribution, transmission and market value) that cause the CTC to fall to zero. Stated another way, the ability to take service under bundled rates mitigates the lack of symmetry in the CTC structure.

Q. As a background for the remainder of your testimony, summarize customer alternatives with and without approval of Edison's Petition.

A. The table below summarizes general options available to customers who use more than 3MW per month assuming the Edison proposal is adopted and assuming that it is not adopted.

Options Currently Available to Customers if Edison's Petition is Denied	Options That Would be Available to Customers if Edison's Petition is Approved
Receiving service under Rate 6L and assessing the economic benefits of switching to delivery services on an annual basis when Edison re-sets the CTC.	Taking service under Rate 6L as of their June 2003 billing period for up to three years, through their May 2006 billing period, precluding them from using Rider PPO. However, if a customer selects an alternative other than rate 6L (such as Rider PPO), he cannot return to Rate 6L service.
Receiving service from Edison alternatives to Rate 6L including Riders to Rate 6L and Edison's real-time pricing tariff, Rate HEP - Hourly Energy Pricing ("Rate HEP.")	Taking service under Edison's real-time pricing tariff, Rate HEP, which would become the default regulated service and which would be the only bundled service available to customers expanding their sites and/or coming off of special contracts.
Receiving delivery service under Rider PPO and paying customer specific transition charges resulting in potential electricity bill savings on a pre-tax basis of up to 8% to 10% because of the mitigation factor in the CTC formula.	Taking service under Rider PPO with reduced benefits because of increased risk that the CTC will be zero as described below.
Receiving "flowed power" from a RES (or as a customer self manager) for a term of one year corresponding to the term of the fixed CTC and then re-assessing the decision in twelve-month intervals, at which point the decision may be to return to bundled service and pay transition charges as long as the transition charge is above zero.	Receiving "flowed power" from an RES (or signing a contract as a customer self-manager) on a various contract terms and incurring transition charges that change on an annual basis, depending on the market index price, without the alternative of returning to bundled service when the market price is high.
Receiving "flowed power" from a competitive supplier for a period of more than one year at a fixed price and incurring the risk of changing transition charges, changing delivery services charges, changing transmission rates, and a changing structure of the wholesale and retail market in Illinois.	Receiving "flowed power" from a competitive supplier for a period of more than one year at a fixed price and incurring the risk of changing transition charges, changing delivery services charges, changing transmission rates, and a changing structure of the wholesale and retail market in Illinois.
Installing on-site generation and generating electricity at the customer premises.	Installing on-site generation and generating electricity at the customer premises.

B. EDISON'S "MARKET ANALYSIS" IMPROPERLY IGNORES THE ROLE THAT CTCs PLAY IN DISCOURAGING COMPETITION

Q. What claims does Edison make regarding its Petition and the Commission's statutory directive to promote the development of the competitive market?

A. Edison asserts that its proposal should be adopted because it supposedly would promote market development, noting that the Act directs the Commission to "promote the development of an effectively competitive market that operates efficiently and is equitable to all customers." (220 ILCS 5/16-101A.) Edison witness Juracek suggests at page 8 of her direct testimony that the market is not developing because the Company is "killing the market with kindness."

Q. Do you agree?

A. Edison may be killing the market, not with kindness, but rather with its insistence upon collecting transition charge revenues from customers. Clearly, the single greatest impediment to development to competitive markets is the CTC. If Edison were truly interested in markets developing rather than enhancing its financial position, it would immediately eliminate the CTC. The magnitude of the CTC in the total price paid by customers for electric service compared to other components of procuring competitive service (such as transmission) make it central to any serious discussion of development of the Illinois retail electric market.

Q. Is there anything in Edison's testimony to suggest that Edison is not serious about trying to promote the development of the competitive market?

A. More telling than anything in Edison's testimony is what it omits. Edison's witnesses McDermott, Juracek, Landon and McNeil do not even mention the CTC in discussions of market development. Edison's omission of the CTC in its discussion of market development is tantamount to "ignoring the elephant in the living room." Neglecting any mention of the CTC seriously calls into question the credibility of all of Edison's analysis of market development.

Q. Do you believe that granting Edison's petition would encourage the development of the competitive market?

A. Not at all. Edison's proposal, if accepted, would strike a blow to the development of competition in the Illinois retail electric market. If the Commission were to approve Edison's proposal, it could even signal the beginning of the end of the competitive market. We may see an immediate migration of customers from competitive supply to Rate 6L, and it is likely that those customers would remain on Rate 6L for much of the duration of the transition period.

C. EDISON'S PROPOSAL WOULD ENRICH SHAREHOLDERS AT THE EXPENSE OF RATEPAYERS

Q. If Edison did not file its petition to encourage competition, why, in your opinion, did Edison make this filing?

A. Edison seeks to maximize value for its shareholders. The Commission should recognize that this proceeding is not all that different from "traditional" rate cases of the 1980s and 1990s, when Edison sought to increase its regulated rates to enrich shareholders. Now, instead of overtly seeking to increase its regulated return on equity, Edison is seeking to relieve itself of obligations, which will in turn increase its earned return on equity. In either case, the result is the same: shareholders gain and electric bills increase.

Q. How does the Edison proposal favor shareholders at the expense of ratepayers?

A. If the Commission were to approve Edison's proposal, Edison would receive at least two (2) significant and distinct financial benefits, both at the expense of affected ratepayers. **First**, the Company would reduce its losses from the "mitigation factor" by limiting the ability of customers to leave Rate 6L. Edison would reduce mitigation factor revenues through generally discouraging customers from participating in the competitive market. More specifically, the decline in mitigation revenues would arise by making service under Rider PPO less attractive to customers.

Second, the Company would realize reduced risk, which is inversely related to customer increases in risk associated with Edison's petition. Edison's proposal would grant the Company a cost free option (as explained below that because of the CTC, customers have never had a cost free option). The option received by Edison is created because Edison can elect to impose CTC's to preserve its revenue level whenever customers choose competitors' services (instead of Rate 6L). Edison's cost-less option arises because of the $0 CTC floor that shifts the risk of high commodity prices, high delivery service prices and high transmission prices to customers. The reduction in risk may not directly show up in Edison's financial statements, but it affects how each dollar of Edison's earnings is valued by shareholders.

1. Edison Would Reduce Its Risk Of Losses From The "Mitigation Factor" By Discouraging Customers From Taking Competitive Service

Q. You suggest that the first way in which Edison would enrich shareholders at the expense of ratepayers is by reducing its losses from the mitigation factor through limiting the number of customers who leave Rate 6L. What is the "mitigation factor"?

A. The mitigation factor represents the amount that is attributed to new revenue sources and cost reductions realized by the utility during the mandatory transition period. In 2003, the mitigation factor increases from 8% to 10% which makes this proceeding even more important to customers and Edison.

Q. How does Rider PPO operate in concert with the mitigation factor?

A. Under Rider PPO, customers should be able to receive the benefits of the mitigation factor while still being supplied by Edison. Since the customers who would be affected by this filing receive individual CTCs, Edison admits that these customers should see the full "mitigation factor" savings under Rider PPO. (*See* Edison Response to City of Chicago Data Request 2.18.)

Q. Would Edison's proposal allow it to reduce its losses from the mitigation factor and limit customers' ability to leave Rate 6L?

A. Yes. As long as customers remain on Rate 6L, Edison would not incur losses from the mitigation factor. Edison's proposal, if it were adopted, would discourage customers from taking service under Rider PPO and would provide customers with a strong incentive to stay on Rate 6L throughout much of the mandatory transition period, rather than participate in the competitive market at all. If Edison's proposal were approved, the safest (and perhaps the only) way in which customers could protect themselves from exposure to high market prices, distribution prices and transmission prices would be to remain on Rate 6L.

Q. Why would Edison's proposal encourage customers to stay on Rate 6L and forgo savings that could be realized from the mitigation factor?

A. Under Edison's proposal, if the customer does not want exposure to high market prices, he must stay on Rate 6L and forgo the mitigation factor savings that would have otherwise been achievable through selecting Rider PPO. These mitigation savings realized by the customer have a commensurate financial cost to Edison, and if customers do not take advantage of Rider PPO because of risk concerns, customers forgo mitigation savings, making Edison better off.

Let's say a hypothetical customer is worried about the market price increasing (perhaps he thinks natural gas prices could spike again). Under the current tariff situation he could limit his exposure by assessing Rate 6L relative to Rater RCDS and Rider PPO on an annual basis when Edison sets the market index price. However, if Edison's proposal to declare Rate 6L competitive were accepted, the customer would not be able to limit his financial exposure by returning to Rate 6L.

2. Edison's Proposal Is Part Of A Scheme To Reduce <u>Customer Benefits From Taking Service Under Rider PPO</u>

Q. Does Edison's proposal seem to be part of a scheme to eliminate or significantly reduce the economic benefits of Rider PPO to customers?

A. Yes. Customers would be much less likely to take Rider PPO service if the Commission were to approve Edison's proposal in the instant proceeding.

Q. Why would customers be less likely to take service under Rider PPO if the Commission were to approve Edison's proposal?

A. Under Edison's proposal, customers would not be allowed to move from Rider PPO back to Rate 6L if market prices increase. For customers to avoid being exposed to high market prices, they must move off Rider PPO and back to Rate 6L prior to their June 2003 billing cycle and then they must remain on Rate 6L. If the customer subsequently decides to take service using Rider PPO, he must be willing to accept the risks associated with being in the competitive market – including risks of delivery services rates increasing -- for the remainder of the mandatory transition period. This contrasts starkly to the current situation, where customers can move from Rider PPO back to bundled Rate 6L service annually in order to limit their exposure to high market prices and a zero CTC.

Q. Do you have any evidence for your contention that customers will stay with bundled service or move back to bundled service, rather than use Rider PPO, in order to limit their exposure to high market prices and zero CTCs?

A. Yes. According to Edison's Response to ICC Staff Data Request HJH 1.09, of the 373 Rate 6L greater than 3MW customers, 17 customers would have a zero CTC utilizing the mitigation factors effective January 1, 2003 and the current Period A low market values. All 17 customers are taking bundled service.

Q. Is there anything in Edison's testimony that makes you believe that Edison wants to reduce the number of customers who take service under Rider PPO?

A. Yes. Edison's desire to limit the number of customers who take service under Rider PPO is illustrated by the following statements made by Arlene Juracek at pages 6 and 12 of her pre-filed direct testimony:

> PPO service will also continue to be available through 2006 to customers on Rate RCDS that do not require standby service and are paying transition charges, although as noted below we believe additional revisions are needed in the PPO rate. These will be the subject of another proceeding.
>
> * * * *
>
> [T]he PPO was originally designed with the intent of providing customer protections against potential Customer Transition Charge ("CTC") calculation manipulation by utilities and against potential hypothesized transmission inadequacies. Instead, it has become, in many cases, a risk-free supply strategy for RESs, who by asking the customer to assign their rights to the PPO supply to the RES, allow the RES to serve the customer with no procurement or scheduling costs or imbalance risk. <u>This tariff also should be limited</u> and we will be making proposals for doing that in the pending Market Value Index ("MVI") workshops and filing scheduled for this summer and fall. (Emphasis supplied.)

Q. Do you agree with Ms. Juracek's assertions relating to reducing the benefits of Rider PPO to customers?

A. No. Rider PPO has been an effective mechanism to generate customer savings and to prompt customers to become familiar with the delivery service process. Rider PPO is an essential pillar in the market transition in Illinois. As long as the CTC exists, the benefits of the PPO should not be reduced.

3. Edison Would Realize Reduced Risk <u>By Imposing Additional Risks Upon Ratepayers</u>

Q. How would Edison's proposal result in an effective price increase through shifting risks from the utility to the customer?

A. On one hand, Edison proposes to impose all of the risks of high market prices on customers because of the zero CTC floor combined with limited options to return to bundled service. On the other hand, when prices are low, Edison insists that it be fully protected by imposition of the CTC. This lack of symmetry imposes significant economic costs to customers and simultaneously enhances Edison's financial position. The risk exists even in relatively low market price environments because of the volatility in electricity prices and because of the structure of Rate 6L to large customers. (Rate 6L above 10 MW has a significant demand discount and can result in a relatively low price for very large customers.)

Q. Can you provide an example of how limiting the ability of a customer to move back from delivery services to bundled Rate 6L service would result in a rate increase?

A. Yes. I have illustrated the impacts of Edison's proposal for customers who use more than 3 MW per month using two hypothetical customers. One customer uses somewhat more than the 3 MW hurdle – 4.7 MW; and, the second customer is a very large user who consumes 57 MW per month. In answering this question I consider the hypothetical customer who uses about 57MW per month.[1] Attachment A includes an analysis for both of the customers.

The following circumstances exist for the very large customer because of his load profile and the structure of the Rate 6L tariff:

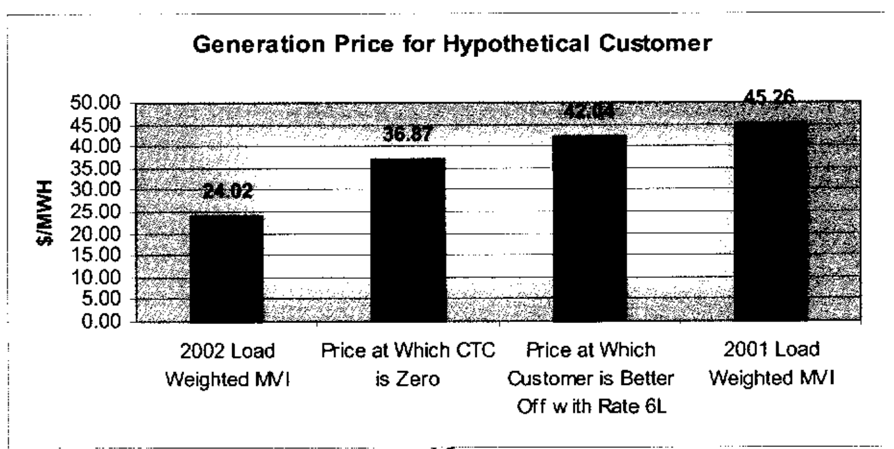
- At the current level of distribution and transmission rates, if the load weighted market value index price exceeds $37MWH, the customer would not pay a transition charge and its savings would be less than the target mitigation factor savings incorporated in the Act.
- If the market index price were above $42.04/MWH, this customer would have been better off by staying on Rate 6L. In other words, if the

[1] I have applied customer usage from an actual building and increased all of the monthly demand and energy usage by constant ratios.

customer selected delivery service, and the market index price was above \$42.04/MWH, the customer would, under Edison's proposal, pay rates that exceed current bundled rates.

- If one applies the market value index for 2001 as the market price for the customer, the customer would have been better off with Rate 6L. The load weighted market price was \$45.26/MWH and hypothetical customer would have saved more than \$1.1 million on an annual basis through remaining on bundled service.
- If the market price were 15% higher than the 2001 market price, the customer would have incurred a cost of more than \$3.4 million through taking delivery service under Rate RCDS and Rider PPO rather than Rate 6L.
- Using current (May 2002) market load weighted market prices, the customer would pay a positive transition charge of \$15.5/MWH. If the customer selected Rider PPO for the year, he would realize savings because of the 8% mitigation factor. The savings on an annual basis would be \$1.28 million.
- If distribution or transmission rates increase, the exposure to high market prices is made worse.

The graph below illustrates market prices and the customer decision.



Q. How could approval of Edison's petition affect this hypothetical customer?

A. Edison's proposal may prompt this customer to stay on Rate 6L and forgo savings that could be realized from the mitigation factor. This foregone savings is analogous to a price increase as if Edison were to file a traditional rate case.

IV.

EDISON HAS FAILED TO SATISFY THE STATUTORY REQUIREMENTS FOR THE COMMISSION TO DECLARE RATE 6L COMPETITIVE

A. BACKGROUND

Q. What is your understanding of the standards that must be met under the Act for a service to be declared competitive?

A. Edison notes in its petition that Section 16-113 of the Public Utilities Act ("Act") provides that "[t]he Commission shall declare [a] service to be a competitive service for some identifiable customer segment or group of customers, or some clearly defined geographical area within the electric utility's service area, if the service or a reasonably equivalent substitute service is reasonably available to the customer segment or group or in the defined geographical area at a comparable price from one or more providers other than the electric utility or an affiliate of the electric utility, and the electric utility has lost or there is a reasonable likelihood that the electric utility will lose business for the service to the other provider or providers . . .." 220 ILCS 5/16-113 (emphasis supplied).

Q. How do you apply the statutory requirements in your testimony?

A. Using the criteria identified above as the focus of this part of my testimony, I examine whether Edison's proposal meets the Act's test for the presence of an effectively competitive market. In other words, I analyze the proposal and current market conditions to determine whether Rate 6L replacement services that require affected customers to assemble various components of Rate 6L service and to pay market prices plus a transition charge (1) are "reasonably equivalent substitute service[s]," (2) are "reasonably available … at a comparable price" and (3) portend a loss of business for Edison if it is denied flexibility to compete and must continue providing tariffed Rate 6L service.

B. THERE IS NO REASONABLY EQUIVALENT SUBSTITUTE SERVICE AVAILABLE IN THE COMPETITIVE MARKET

Q. Explain how switching to Rate 6L protects customers in high market price environments.

A. In high market price environments, the CTC has a floor of zero. This means that despite the transition charge being derived from a lost revenue formula, customers can experience higher prices taking delivery service than from taking bundled service under Rate 6L. If the market price is high and the CTC is zero, the total customer bill from taking delivery service can be higher than the Rate 6L electric bill. Lacking the ability to switch from delivery service to bundled service when Edison re-sets the transition charge, customers are exposed to high market prices.

Q. Does a similar exposure exist to increases in delivery services rates and increases in transmission prices?

A. Yes.

Q. Has Edison demonstrated that limiting the ability to realize fixed price service comparable to Rate 6L is available from the market?

A. No. If a customer wants to realize a total electric bill that does not vary with market prices, he must deal with variability in the CTC, variability in delivery services rates, variability in transmission prices and variability in market prices. Comparable service offered by a RES must therefore be geared to the timing of changes in the CTC, and the RES must be able to lock in power rates without a risk premium at time periods that correspond to the re-setting of the transition charge.

Q. **What would have to be available in the competitive market in order for there to be a "reasonably equivalent substitute" to Rate 6L?**

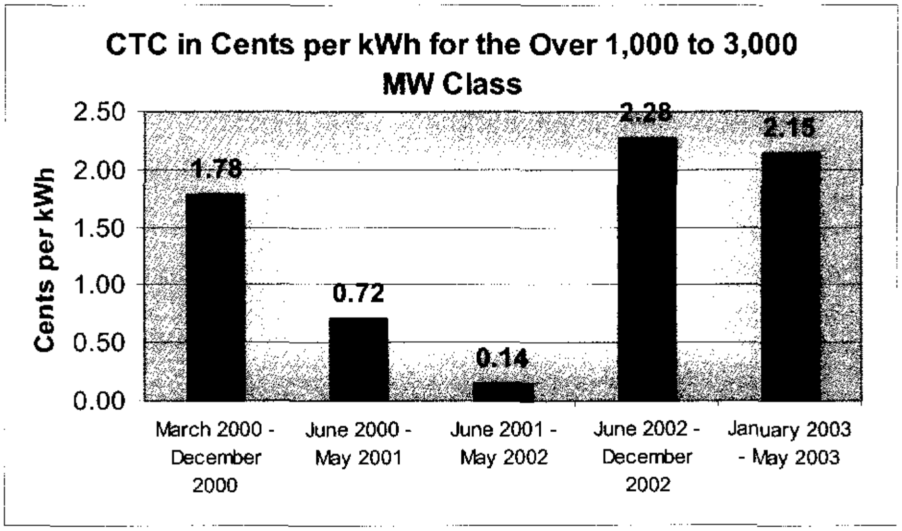
A. Competitive suppliers would have to accept the financial cost of providing insurance for price exposure when the CTC hits a floor of zero as described in Attachment A. In other words, for service to be comparable to current service, the suppliers would have to offer customers insurance that "all-in" rates will not exceed the Rate 6L service rate. The insurance would have to cover all of the costs for peak and off peak pricing, load following, imbalance credit, and costs associated with purchasing non-standard blocks of electricity load and so forth.

Q. **In its testimony has Edison demonstrated that suppliers are offering this type of insurance?**

A. No.

Q. **Using the current available options to customers as described in your earlier question, summarize your understanding of recent market activity.**

A. Edison's changes to its CTCs have significantly affected market activity. The graph below illustrates transition charges for "Period A" paid by customers in the over 1,000 to 3,000 MW class. It is my understanding that these transition charges are representative of the charges incurred by customers who use more than 3MW per month. The graph demonstrates a great deal of variability in transition charges and the fact that Edison significantly increased transition charges in May, 2002.



Q. What was the impact upon the competitive market of the huge swing in the CTCs?

A. It was extremely disruptive. Because of the transition charges, it is my understanding that:

- Despite extremely low wholesale prices in the Midwest, customers were unable to benefit from the market decline because of correspondingly high CTC charges.
- RESs have had trouble in May 2002 offering flowed power service that is fully competitive with Rider PPO. That is, including costs such as off peak pricing, load following costs, imbalance costs, allocations of sales and marketing expenses, credit costs, retail profit margins, costs associated with purchasing non-standard blocks of electricity load and so forth. The primary reason that RES's presently are flowing power to serve customers is that Edison's affiliate provided a wholesale discount to RES's.
- Customers who signed long-term power contracts in 2000 or 2001 have incurred economic losses relative to service that would otherwise be available under Rate 6L or under Rider PPO because of the increase in the

transition charge. For example, if a long-term contract was signed using an expectation of a one-cent CTC, the customer experiences a significant price increase when the CTC is increased. ~~To illustrate, the Roundtable Report,~~ quotes a market participant who notes that

> [I]t is extremely difficult for customers to enter into long-term supply contracts without incurring very significant - possibly prohibitive - financial risk. In contrast, incumbent utilities can enter into long term supply contracts with much less risk than their customers." (Roundtable Report, page 7.)

When the transition charge is high as in May 2002, the number of customers who switched to delivery service and receive flowed power since May 2002 is limited.

C. RATE 6L SERVICE IS NOT AVAILABLE IN THE COMPETITIVE MARKET AT A COMPARABLE PRICE

Q. Is Rate 6L service, or a reasonably equivalent substitute, available in the competitive market at a comparable price?

A. No. Contrary to Edison's assertions, the services that Edison provides under Rate 6L are not available in the competitive market at comparable prices. Because customers incur positive transition charges, and bear greater risks in the competitive market, the services that are available in the competitive market are only available at a significantly higher effective price to customers than the services provided under Rate 6L.

Q. Please explain why, from a customer perspective, Edison's proposal to declare Rate 6L service competitive for customers who use more than 3MW is not "available at a comparable price" to currently available service?

A. To determine the "effective" price faced by a customer, risks must be accounted for in addition to the "expected" price. If the expected price is the same for two alternatives, but the risk associated with one alternative is higher than the risk associated with other alternative, the effective prices of the two alternatives are not the same. For the case in which the risk is greater, the effective price is higher. By burdening customers with greater risk without any reduction in the CTC, the Edison proposal amounts to an effective price increase to customers.

Q. Is there a test that the Commission could use to determine whether a reasonably equivalent substitute service is available at a comparable price?

A. Yes. The Commission should ascertain whether the customer group would be worse off after the declaration of the service as "competitive." Presumably, if there is reasonably equivalent service available at a comparable price, the customers would not be harmed. That is, the customer would be able to acquire service at a similar price.

Q. Would customers be worse off if the Commission were to declare Rate 6L comparable?

A. Yes. Simply listing the options available to large customers before and after Edison's proposal would be implemented amply demonstrates that these customers have inferior service if Edison's proposal is adopted. Relative to the economic position of customers and Edison today, the Company's proposal would limit customers from being able to achieve mitigation savings from Rider PPO, prevent customers from being able to protect themselves from high market prices by switching to Rate 6L, and deny customers the opportunity to realize fixed prices from Edison without precluding themselves from realizing the mitigation savings.

Q. Does Edison recognize that it is imposing significant additional risks on customers in its proposal?

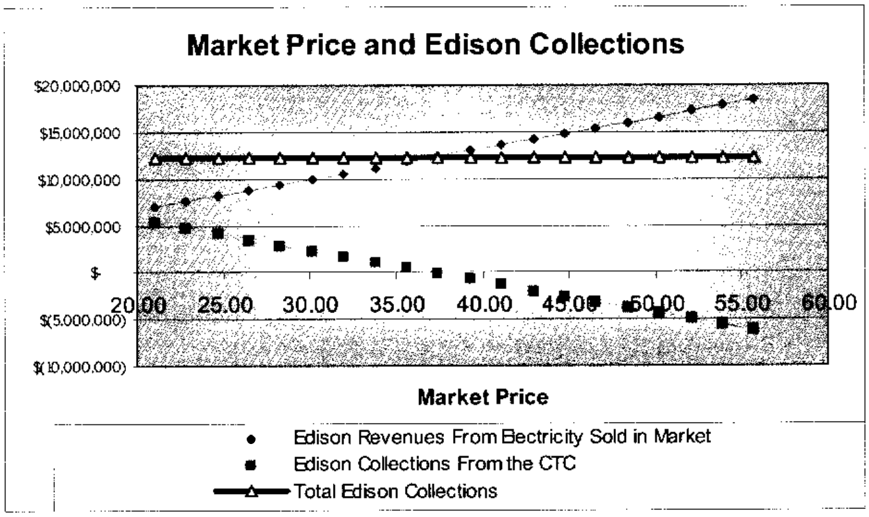
A. No. Edison incorrectly characterizes current customer alternatives to return to Rate 6L service as a "free option."

Q. Why is Edison's characterization of the alternative to return to Rate 6L a free call option incorrect?

A. Edison entirely ignores the CTC in its description of tariffed rates as a "free option." Ignoring the CTC is like ignoring the cover charge to a bar, and claiming that you were able to hear the band for free. With the CTC, Edison is protected from market price movements and customers are providing an option to Edison, not the other way around. I have demonstrated this in Attachment A. In the attachment, I use the financial definitions of forward contacts and options contracts to work through customer and Edison exposure to market price changes in the context of the CTC.

Q. Can use of a "payoff" diagram illustrate how the CTC protects Edison from market price fluctuations?

A. Yes. The diagram below illustrates how Edison is protected from market price fluctuations. The CTC provides positive revenues to Edison when the market price is low and the revenue loss it experiences from selling power that it cannot sell to the delivery services customer is the greatest. The net of the positive revenues from the CTC and the revenue losses from selling freed power leaves Edison unexposed to market price fluctuations. This is illustrated by the thick black line in the graph. The diagram uses data for the hypothetical large customer described in Attachment A.

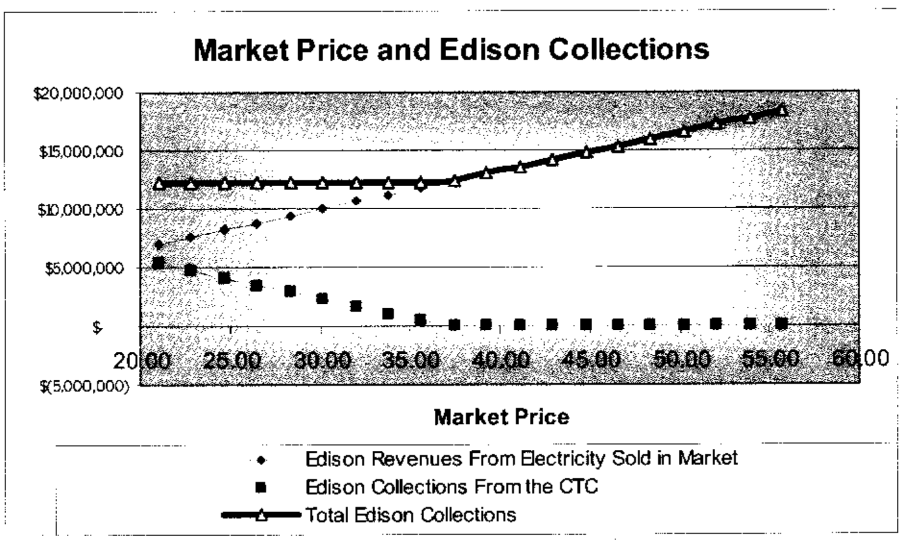


Q. **How does the customer alternative to switch to bundled service affect Edison's payoff structure under different market prices?**

A. Ignoring the mitigation factor savings and the floor of zero on the CTC, switching to bundled service does not affect Edison's financial payoff because the CTC is designed to protect Edison's base rate revenues. Switching between Rate 6L and delivery service should result in the similar financial consequences to Edison (except for the mitigation factor revenues) no matter how high or low the market price moves.

Q. **Can you use a diagram to explain how the CTC floor of zero provides a cost free option to Edison.**

A. Yes. As was the case above when the CTC was allowed to become negative, one can graph the Edison financial payoffs under alternative market price



environments that result when the CTC has a floor of zero. This time, the graph has a classic option structure where the Edison payoff increases after a certain hurdle (the exercise price or the zero CTC) is met. The graph shows that Edison's payoff increases with the market price once the CTC floor of zero is reached. This is a classic call option structure that occurs from buying an option on a stock. The reason the CTC has this option characteristic is describe in Attachment A.

Q. How does the customer alternative to return to service under Rate 6L affect this option structure?

A. Under the current Rate 6L tariff structure, a customer may lose the mitigation factor savings when market prices increase, but his downside is limited through having the ability to return to 6L service. However, without the ability to return to Rate 6L service, the customer would be fully exposed to market price increases. By limiting the customers' ability to mitigate electric bill increases from rising market prices, the Edison petition completely monetizes the free option for itself.

D. IT IS NOT NECESSARY FOR THE COMMISSION TO DECLARE RATE 6L COMPETITIVE IN ORDER TO MODERATE AN ECONOMIC LOSS TO EDISON

Q. Explain how you assess the provision in the Act relating to whether "the electric utility has lost or there is a reasonable likelihood that the electric utility will lose business for the service to the other provider or providers."

A. My understanding of this provision in the Act is that it is intended to provide financial protection to an incumbent utility company if the utility is losing business to competitors because it cannot react to market forces. Protection of the incumbent utility company will -- in theory -- reduce costs to the remaining captive customers. For example, in the telecommunication industry, conference call service can be purchased as a part of the phone itself (I understand that there are phones that include service packages from retail suppliers such as Radio Shack). Alternatively, the conference call service can be purchased from the local Phone Company. Radio Shack may have sales and promotions to encourage consumers to purchase its products. Without the flexibility to adjust prices to these promotions, the local phone company may be in a position where it cannot sell utility services that are economical (i.e can be produced above short-run marginal cost) and where profit earned from the sales could reduce overall revenue requirements.

Q. Is Edison's purported economic loss consistent this premise of reacting to market forces?

A. Not at all. First, Edison is not providing a competitive service in which it needs the flexibility to protect revenue streams from captive customers analogous to the conference call example. Second, there is an obvious mechanism – the CTC – that is designed to protect Edison from lost revenues. The CTC is designed as a lost revenue formula to make Edison indifferent to generation volume lost to competitors. Through the mechanism of the market value index price, if Edison loses sales to customers, it can make up for financial losses on the re-sold power in the open market. The CTC therefore protects 6L revenues, and eliminates downside to Edison. Since Edison is proposing to retain the transition charge, the economic loss from customers leaving the system must be evaluated in the overall context of the provision of transition charges in the Act.

Q. Is it necessary for the Commission to declare Rate 6L competitive in order to prevent Edison from suffering economic harm?

A. No. The issue of financial loss to Edison can only be evaluated in the context of the transition charge. The CTC protects Edison from realizing significant financial loses when customers take service from competitors, and the basic function of the CTC is to make Edison financially indifferent to consumers selecting alternative suppliers. There is substantial evidence that the CTC has adequately protected Edison from exposure to customers selecting competitive alternatives. As long as the CTC is in existence, there in no need to declare the provision of electric power and energy competitive.

Q. But isn't Edison being financially harmed through providing Rate 6L as its "provider of last resort" rate?

A. No. Contrary to Edison's assertions, the Company is not harmed from being the "provider of last resort." The analysis of the CTC under different market price environments contained in Attachment A demonstrates that, because of the mechanics of the CTC, the alternative to return to bundled service has not been a "free option" for customers. In fact, if the Commission were to approve Edison's proposal, Edison would receive -- not incur -- a free option from its customers. The Company's proposal would enhance Edison's already strong financial position that results in large part from realizing CTC's.

Q. Is there evidence that CTC is adequately protecting Edison?

A. Yes. If Edison is recovering its stranded investment after realizing mitigation savings, its return on equity should approximate its cost of equity capital. In my testimony in the delivery services case (ICC Docket No. 01-0423), I demonstrated that Edison is earning very high returns on equity after adjusting for accounting adjustments. (*See* Attachment B attached hereto and made a part hereof). This implies that Edison could be recovering significantly more than its stranded investment. Edison's strong financial position is also confirmed by its recent earnings report. I have attached an article that quotes Exelon's Chief Financial Officer, Ruth Anne Gillis and John Rowe boasting about the operating earnings that have been achieved recently by Edison. (*See* Attachment C attached hereto and made a part hereof.) The article certainly does not suggest that Edison is in dire financial straits because of problems from offering tariffed service for Rate 6L customers.

Q. How do you respond to the concern raised at pages 23 to 24 of the direct testimony of Edison witnesses McNeil and Sterling that due to the fact that the PPO price does not fluctuate as frequently as wholesale market prices, RESs use the PPO as a part of their supply strategy?

A. As an initial point, setting aside Edison's bare assertions, there is no reason to believe that the General Assembly did not intend for this to be a component of the competitive market. That is, as Edison witnesses McNeil and Sterling admit at page 23 of their direct testimony, the RESs actions are "predictable behavior of marketers making rational economic decisions . . .." Presumably, the General Assembly would have predicted that the RESs would act in an economically rational manner. Further, Edison's exposure is minimal and to the extent that any such exposure exists, my financial analysis that was presented in Edison's delivery services proceeding demonstrates that Edison is perfectly capable of accepting this risk. (See Attachment B to this testimony.) Finally, the "problem" that they have identified has nothing to do with whether Rate 6L should be declared competitive. The "problem" is a timing "problem" related to frequency of resetting the MVEC's that could, and should, be addressed in proceedings related to Edison's MVEC.

Q. Would Edison experience a financial gain through implementation of its proposal?

A. Yes.

Q. Does Edison need to experience a gain in financial position to moderate losses experienced from customers switching to competitive service?

A. No. Edison's losses from the mitigation factor revenues were developed as a key component of the Act. The Act certainly contains many benefits for Edison, but contrary to Edison's implication, the Act does intentionally impose some costs upon Edison too. Nothing in the current environment suggests that the basic economic transfers contemplated in the Act have been skewed against Edison to the point where the Commission must impose added costs on customers. Financial analysis of Edison demonstrates that the opposite is true. If the outcome of the Act is different from the contemplated result, it is Edison who has gained.

V.

SUMMARY OF RECOMMENDATIONS

Q. Please summarize your recommendations.

A. The Commission should deny Edison's petition. In the language of the Act's criteria:

1. The available replacement services or service components taken in conjunction with Edison's delivery services tariffs – which impose a non-negative transition charge – are not substitutable for Rate 6L bundled service combined with Rate RCDS service;
2. Effective economic prices to affected customers would not be comparable, but increased -- because Edison is reducing the choices available to customers and shifting additional market risks onto customers; and
3. Edison is fully protected by its CTC against any loss of business to competitors and would be unnecessarily enriched by using the competitive declaration to discontinue its provision of Rate 6L service rather than to compete.

Q. If the Commission decides not to deny Edison's petition outright, do you have any alternative recommendations?

A. Yes. In lieu of rejecting outright Edison's proposal to address the alleged impediments to market development discussed in its petition, it would be reasonable for the Commission to condition a competitiveness declaration on simultaneous elimination of the most significant impediment to development of competitive markets – Edison's CTC. This alternative, however, should be approved only after a comprehensive study of Edison's recovery of the CTC. The study should assess the Company's possible economic gain or loss and also should take into account revenues received from efficiencies achieved through the merger and plant sales in which Edison and its parent entities have been involved.

Q. Does this conclude your testimony?

A. Yes.

A

THE CTC, OPTIONS AND FORWARD CONTRACTS: *WHY EDISON'S PROPOSAL RESULTS IN A FREE OPTION FOR THE COMPANY AND WHY THERE IS NO FREE OPTION FOR CUSTOMERS*

INTRODUCTION

Edison's claim that it is providing a "free option" to customers is simply wrong. In reality, as a result of the CTCs, it is Edison who is receiving the free option. The analysis in this Attachment demonstrates this fact.

This attachment begins by summarizing Edison's testimony with respect to the provision of a cost free option. Next, I define a forward contract and an option contract in a general manner. Third, I define customer arrangements with Edison (including the CTC) in the context of option contracts and forward contracts. With these definitions in hand, I walk through how customer bills are impacted by different market prices in the next two sections. The fourth section includes an example where the CTC is assumed to be allowed to decline below zero. The fifth section changes the example so as not to allow negative CTCs. The final section summarizes conclusions from the analysis in the context of Edison's petition to declare Rate 6L service competitive.

EDISON'S TESTIMONY

Edison incorrectly characterizes current customer alternatives to return to Rate 6L service as a "free option." Ms. Juracek testifies:

> The fixed price bundled service offered to customers in the 3 MW and above group through Rate 6L can be used by customers as an option that can be chosen whenever market prices rise above the fixed-price level. They can then abandon that rate when market prices are lower. For customers with the clear ability, either directly or through the services of agents and suppliers, to understand and manage competitive choices, Rate 6L is an overly protective offering that in effect discourages customers and suppliers from proactively hedging supplies through the market. (Juracek testimony at page 12.)

Dr. Landon testifies that:

> One of the problems with the fixed-price bundled service offerings like Rate 6L is that, when they cease to be needed as a service option, they begin to function as a costless "call option" that enables large customers to be assured of the "lower of" market or cost-based utility prices. (Landon testimony at page 18.)

The analysis below demonstrates that both Ms. Juracek and Dr. Landon are wrong.

GENERAL DEFINITIONS

A **forward contract** locks in a future price for the buyer and seller of the contract. The forward contract protects the seller and/or purchaser of an item from future fluctuations in market price. It allows companies to avoid risk of future price changes on its business. For example, if an airline company wants to protect itself against future increase in the price of jet fuel, the company can purchase a forward contract that locks in the future price. An oil company can sell the same forward contract to protect itself against financial losses that occur when the price declines. The forward contract does not have a strike price or an exercise price that allows the payoff structure on the contract to change when future price exceeds or declines beyond some pre-determined level.

In an **option contract**, something happens if the price exceeds a hurdle or exercise price, but something else happens if the price does not reach the exercise price. The holder of the option does not have the same payoff under all price possibilities. In the case of a call option, the holder (buyer) of the option can experience financial returns if the price moves above the strike price level. For example, if an executive of a corporation has been granted an option on shares as part of his compensation package, the executive receives a payoff only if the stock price exceeds the strike price. The payoff from the option means that the holder of the option receives one dollar of return for each dollar the realized price is above the strike price.

FORWARD AND OPTION CONTRACTS IN THE CONTEXT OF EDISON'S CTC

If the current lost revenue formula that forms the basis of the CTC provided symmetrically for negative CTCs, Edison and its customers essentially would have entered into a forward contract, not an option contract. When the market price (and delivery service price and transmission price) is low, and customers switch to delivery services, Edison can increase the CTC and Edison has protected itself. On the other hand, if the market price is high, (or the delivery service rate or the transmission price increases) the CTC is low but Edison realizes more money from selling power that is freed up when the customer leaves the system. This is analogous to a forward contract with a fixed price. Except for the CTC floor of zero, the lost revenue formula that is the basis for the CTC has the characteristic of a forward contract because it does not have exercise prices that produce payoff patterns analogous to an option.

The floor of zero on the CTC changes the payoff structure for Edison and customers from a forward contract to an option contract. However, since Edison gains from the CTC floor and customers are harmed by the CTC floor, the option value is provided by customers and is received by Edison. More technically, Edison receives a call option because it gains net revenue value when the market price is high through the floor of zero on the CTC. Customers provide this call option to Edison at no cost. In sum, there is a cost free option for Edison in current tariffs because of the fact that the transition charge cannot fall below zero. This is an option that benefits Edison and is costly to customers, not a free option to customers, in contravention to Ms. Juracek's and Dr. Landon's statements.

EXAMPLES ASSUMING NEGATIVE CTC'S EXIST

The CTC is designed to protect Edison from financial loss when the market price is low. The following tables illustrate how Edison's revenues from 6L customers are protected in alternative market price environments for two customers. The first table is for a customer who uses about 57 MW per month and the second table represents a customer who uses about 4 MW per month with a higher load factor. Both tables assume the 2003 mitigation factor percentage of 10% and current delivery service rates and transmission prices. If the delivery service rates and transmission prices increase, the customer specific transition charge declines and the negative CTC occurs at an earlier market price point.

The first two columns in each table show the range in the load weighted average market price, the third column shows the customer specific transition charge assuming the transition charge can decline below zero. The forth column shows Rate 6L prices and the fifth column shows total prices that would be incurred if the customer selected Rider PPO. The sixth column shows the percentage bill savings realized by the customer in the alternative rate environments. Finally, the seventh through the ninth column show the revenues Edison realizes from the customer and from selling power that is "freed" when it does not have to secure power for the customer.

The table simulates a range in price from 20% below the current (May 2001) market index price to 20% above the market index price last year (May 2002). The final column in the table demonstrates that Edison would be made whole at different market prices through the transition charge for both customers. Stated in a different way, the table demonstrates that Edison is not exposed from a financial perspective to customers exercising some kind of free option.

Table 1: Simulation of Edison Revenues, Customer Costs and CTC in Different Market Price Environments

Base Market Price ($/MWH) 24.07 Average Demand (kW) 56,932

Percent of Base Price	Market Price (Load Weighted $/MWH)	Transition Charge ($/MWH)	Rate 6L Price ($/MWH)	Delivery Price ($/MWH)	Savings From Delivery Service	Edison Revenues From Electricity Sold in Market	Edison Collections From the CTC	Total Edison Collections
80%	21.09	17.69	53.85	48.47	10%	$ 6,953,445	$ 5,295,794	$ 12,249,238
88%	22.91	15.67	53.85	48.47	10%	$ 7,556,711	$ 4,692,527	$ 12,249,238
95%	24.74	13.66	53.85	48.47	10%	$ 8,159,978	$ 4,089,260	$ 12,249,238
103%	26.57	11.64	53.85	48.47	10%	$ 8,763,245	$ 3,485,993	$ 12,249,238
110%	28.40	9.63	53.85	48.47	10%	$ 9,366,512	$ 2,882,726	$ 12,249,238
118%	30.23	7.61	53.85	48.47	10%	$ 9,969,779	$ 2,279,459	$ 12,249,238
126%	32.06	5.60	53.85	48.47	10%	$ 10,573,046	$ 1,676,193	$ 12,249,238
133%	33.89	3.58	53.85	48.47	10%	$ 11,176,313	$ 1,072,926	$ 12,249,238
141%	35.72	1.57	53.85	48.47	10%	$ 11,779,580	$ 469,659	$ 12,249,238
148%	37.55	(0.45)	53.85	48.47	10%	$ 12,382,847	$ (133,608)	$ 12,249,238
156%	39.38	(2.46)	53.85	48.47	10%	$ 12,986,113	$ (736,875)	$ 12,249,238
164%	41.21	(4.48)	53.85	48.47	10%	$ 13,589,380	$ (1,340,142)	$ 12,249,238
171%	43.04	(6.49)	53.85	48.47	10%	$ 14,192,647	$ (1,943,409)	$ 12,249,238
179%	44.87	(8.50)	53.85	48.47	10%	$ 14,795,914	$ (2,545,865)	$ 12,250,049
186%	46.70	(10.52)	53.85	48.47	10%	$ 15,399,181	$ (3,149,942)	$ 12,249,238
194%	48.53	(12.54)	53.85	48.47	10%	$ 16,002,448	$ (3,753,208)	$ 12,249,238
202%	50.35	(14.55)	53.85	48.47	10%	$ 16,605,715	$ (4,356,476)	$ 12,249,238
209%	52.18	(16.56)	53.85	48.47	10%	$ 17,208,982	$ (4,959,743)	$ 12,249,238
217%	54.01	(18.58)	53.85	48.47	10%	$ 17,812,248	$ (5,563,010)	$ 12,249,238
224%	55.84	(20.59)	53.85	48.47	10%	$ 18,415,515	$ (6,166,277)	$ 12,249,238

Table 2: Simulation of Edison Revenues, Customer Costs and CTC in Different Market Price Environments

Base Market Price ($/MWH) 25.26 Average Demand (kW) 4,200

Percent of Base Price	Market Price (Load Weighted $/MWH)	Transition Charge ($/MWH)	Rate 6L Price ($/MWH)	Delivery Price ($/MWH)	Savings From Delivery Service	Edison Revenues From Electricity Sold in Market	Edison Collections From the CTC	Total Edison Collections
80%	22.13	20.17	58.51	52.66	10%	$ 745,459	$ 653,876	$ 1,399,335
88%	24.05	18.18	58.51	52.66	10%	$ 810,133	$ 589,201	$ 1,399,335
96%	25.97	16.18	58.51	52.66	10%	$ 874,808	$ 524,527	$ 1,399,335
103%	27.89	14.19	58.51	52.66	10%	$ 939,482	$ 459,852	$ 1,399,335
110%	29.81	12.19	58.51	52.66	10%	$ 1,004,157	$ 395,178	$ 1,399,335
118%	31.73	10.20	58.51	52.66	10%	$ 1,068,831	$ 330,503	$ 1,399,335
126%	33.65	8.20	58.51	52.66	10%	$ 1,133,506	$ 265,829	$ 1,399,335
133%	35.57	6.21	58.51	52.66	10%	$ 1,198,180	$ 201,154	$ 1,399,335
141%	37.49	4.21	58.51	52.66	10%	$ 1,262,856	$ 136,480	$ 1,399,335
148%	39.41	2.22	58.51	52.66	10%	$ 1,327,529	$ 71,806	$ 1,399,335
156%	41.33	0.22	58.51	52.66	10%	$ 1,392,204	$ 7,131	$ 1,399,335
164%	43.25	(1.78)	58.51	52.66	10%	$ 1,456,879	$ (67,544)	$ 1,399,335
171%	45.16	(3.77)	58.51	52.66	10%	$ 1,521,553	$ (122,218)	$ 1,399,335
179%	47.08	(5.77)	58.51	52.66	10%	$ 1,586,228	$ (186,893)	$ 1,399,335
186%	49.00	(7.76)	58.51	52.66	10%	$ 1,650,902	$ (251,567)	$ 1,399,335
194%	50.92	(9.76)	58.51	52.66	10%	$ 1,715,577	$ (316,242)	$ 1,399,335
202%	52.84	(11.75)	58.51	52.66	10%	$ 1,780,251	$ (380,916)	$ 1,399,335
209%	54.76	(13.75)	58.51	52.66	10%	$ 1,844,926	$ (445,591)	$ 1,399,335
217%	56.68	(15.74)	58.51	52.66	10%	$ 1,909,600	$ (510,265)	$ 1,399,335
224%	58.60	(17.74)	58.51	52.66	10%	$ 1,974,275	$ (574,940)	$ 1,399,335

The final column in each table demonstrates that Edison is made whole if a negative CTC is present. This payoff structure is analogous to a forward contract, not an option contract. Edison has reduced its exposure to market price declines in a manner similar to the oil producing company described above. Similarly, the customer is protected from price increases as was the case for the airline company in the above example.

EXAMPLES ASSUMING CTC'S HAVE A FLOOR OF ZERO

The two tables below illustrate how payoffs are affected with a CTC floor of zero for the two customers used in the previous analysis. The tables have the same data when the market price is low. However, when the price is high, Edison now receives a net revenue benefit when customers switch to delivery service. The benefit occurs because Edison can sell power that is freed at a high price and

Table 4: Simulation of CTC in Different Market Price Environments

Base Market Price ($/MWH) 25.26 Average Demand (kW) 4,200

Percent of Base Price	Market Price (Load Weighted $/MWH)	Transition Charge ($/MWH)	Rate 6L Price ($/MWH)	Delivery Price ($/MWH)	Savings From Delivery Service	Edison Revenues From Electricity Sold in Market	Edison Collections From the CTC	Total Edison Collections
80%	22.13	14.83	58.51	52.66	10%	$ 745,459	$ 480,904	$ 1,226,363
88%	24.05	12.84	58.51	52.66	10%	$ 810,133	$ 416,229	$ 1,226,363
95%	25.97	10.84	58.51	52.66	10%	$ 874,808	$ 351,555	$ 1,226,363
103%	27.89	8.85	58.51	52.66	10%	$ 939,482	$ 286,880	$ 1,226,363
110%	29.81	6.85	58.51	52.66	10%	$ 1,004,157	$ 222,206	$ 1,226,363
118%	31.73	4.86	58.51	52.66	10%	$ 1,068,831	$ 157,531	$ 1,226,363
126%	33.65	2.86	58.51	52.66	10%	$ 1,133,506	$ 92,857	$ 1,226,363
133%	35.57	0.87	58.51	52.66	10%	$ 1,198,180	$ 28,182	$ 1,226,363
141%	37.49	-	58.51	53.78	8%	$ 1,262,855	$ -	$ 1,262,855
148%	39.41	-	58.51	55.78	5%	$ 1,327,529	$ -	$ 1,327,529
156%	41.33	-	58.51	57.77	1%	$ 1,392,204	$ -	$ 1,392,204
164%	43.25	-	58.51	59.77	-2%	$ 1,456,879	$ -	$ 1,456,879
171%	45.16	-	58.51	61.76	-6%	$ 1,521,553	$ -	$ 1,521,553
179%	47.08	-	58.51	63.76	-9%	$ 1,586,228	$ -	$ 1,586,228
186%	49.00	-	58.51	65.75	-12%	$ 1,650,902	$ -	$ 1,650,902
194%	50.92	-	58.51	67.75	-16%	$ 1,715,577	$ -	$ 1,715,577
202%	52.84	-	58.51	69.74	-19%	$ 1,780,251	$ -	$ 1,780,251
209%	54.76	-	58.51	71.74	-23%	$ 1,844,926	$ -	$ 1,844,926
217%	56.68	-	58.51	73.73	-26%	$ 1,909,600	$ -	$ 1,909,600
224%	58.60	-	58.51	75.73	-29%	$ 1,974,275	$ -	$ 1,974,275

The final column in the two tables that do not allow a negative CTC demonstrate that Edison is better off if market prices increase. This time, the payoff structure is analogous to an option contract, not a forward contract. Edison realizes gains as if it held an option on a stock where the strike price corresponds to a zero CTC. Like the executive in the example above, Edison can exercise the option when the price increases.

CONCLUSION

The examples above illustrate that the CTC structure results in an option structure realized by Edison. Currently, customers can moderate the negative effects of this option through returning to Rate 6L service for at least one year when the market value index becomes very high. If Edison's petition is approved however, the cost of the option to customers can no longer be limited, and Edison will fully realize the benefits of the cost free option.

B

ATTACHMENT B

GC Ex. 1.0

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Commonwealth Edison Company	)	
	)	
Petition for approval of delivery services tariffs	)	
and tariff revisions and residential delivery services	)	No. 01-0423
implementation plan and for approval	)	
of certain other amendments and additions	)	
to its rates, terms and conditions	)	

DIRECT TESTIMONY OF EDWARD C. BODMER

ON BEHALF OF

THE CITY OF CHICAGO
PEOPLE OF THE STATE OF ILLINOIS
COOK COUNTY STATE'S ATTORNEY'S OFFICE
THE CITIZENS UTILITY BOARD

DATED: August 23, 2001

Q. **Are there other historical factors that the Commission should consider in its evaluation of the policy issues in this case?**

A. Yes, there are. Given the magnitude of the proposed increases, their effects on customers and on competition, and the impact on Edison's financial position, the Commission should be mindful of certain historical factors. First, the expectation of the General Assembly was that the Electric Customer Choice and Rate Relief Act of 1997 would have significant economic benefits for customers as well as for utilities. (See 220 ILCS 5/16-101A(b), (e)). As evidenced by the level of Edison's recent adjusted earned return on equity of above 20%

before special accounting adjustments, Edison has already reaped significant benefits from the legislation. However, elements of Edison's proposal would adversely affect the availability of expected price and competition benefits for consumers. Second, the Commission already has determined statewide policy on a number of delivery services issues that Edison now proposes to reverse, only for itself. Such issues include the use of embedded cost methodology for delivery services rates and for billing and metering credits, inclusion of "retail adders" in the market value credit, and the appropriateness of "demand ratchets."

Q. What are some of the benefits Edison has realized under that legislation?

A. Benefits afforded to Edison include: securitization; the ability to sell generating assets with minimal Commission review; the ability to reorganize with minimal Commission review; the ability to enter into special contracts and "billing experiments" with little or no Commission review; the ability to compete both outside and inside its service territories; the ability to amortize regulatory assets (thereby keeping nominal return on equity below the earnings cap); the ability to use goodwill amortization and merger accounting to keep earnings below the earnings cap; and, the ability to collect transition charges under a lost revenue approach. Each of these authorizations promised and delivered significant financial or competitive benefits to Edison.

Q. What anticipated consumer benefits are at risk under the Edison proposal?

A. Due to the high level of delivery services tariff rates, many customers will not have a realistic opportunity to achieve savings by switching to delivery service. Further, when the period of frozen rates ends, the increases in delivery charges, the high level of market prices, and a larger rate base imply that overall rates (bundled and unbundled) would increase.

Q. Why are the benefits realized by Edison under the Act appropriately considered here?

A. A number of issues in this proceeding will require a balancing of the costs and benefits of alternative policies, where the final decision will not be perfect from all perspectives. For example, attempting to guarantee "penny-by-penny" cost recovery favors Edison, but may conflict with the development of vibrant competitive markets that favors consumers. Similarly, acceptance of (a) rate base additions related to Edison's highly publicized distribution reliability problems and (b) proposed cost recovery for the Company's billing systems, without comprehensive "significant additions" audits would give Edison financial benefits, but would preclude a comprehensive review of all relevant information.

It is important for the Commission to know that procedures required to assure just and reasonable rates will not jeopardize the overall financial integrity of Edison, even if the procedures necessitate delaying rate base additions or imposing conditions on such additions.

Q. Can you give an example of how such factors might come into play?

A. Yes. Arlene Juracek states in her testimony: "Indeed, since the frozen rates are in many cases well below the sum of the delivery rate, the market value, the mitigation factor, and the CTC, Edison's shareholders are in fact funding the majority of the incremental revenue requirement over and above that included in the last approved bundled services rates." This suggests that Edison would anticipate a rate increase to bundled customers in the absence of the statutory rate freeze. Contrary to Ms. Juracek's statement, a simple review of Edison's financial performance demonstrates that from a traditional return on equity perspective, a rate reduction could be justified in the absence of a rate freeze. However, Ms. Juracek's statement does illustrate the future effect of Edison's proposal on customers whose rates are now frozen: Edison would increase rates to residential customers by about 12% ($241 million), based on the use of market based pricing rather than actual generation costs.

Q. What is Edison's recent financial performance in terms of income produced for equity holders?

A. Using data from Edison's FERC Form 1 and its SEC 10K, I have calculated that the Company earned a return on equity of 12.7% in the year 2000. I have computed this return by dividing Edison's net income to common shareholders ($729 million) by its average common equity balance ($5.740 billion). Edison's earnings were at this level (a) even though it amortized more than $200 million of nuclear plant regulatory assets, (b) despite the fact that the Company incurred premium costs in its distribution investment and O&M expenses to remedy past management errors, and (c) even though Edison significantly increased its common equity balance through using purchase accounting for the PECO merger. Notwithstanding these substantial income deductions and equity write-ups, which are not attributable to the provision of delivery services to ratepayers, the earned return on equity of 12.7% exceeds reasonable estimates of Edison's cost of capital.

Absent these non-delivery service cost adjustments, a calculation of Edison's return on equity would yield a higher profit level. According to data provided by Edison, the Company made two adjustments to its common equity balance in the fourth quarter of 2000. Edison increased common equity by $2.379 billion associated with recording goodwill for the PECO purchase and Edison reduced common equity by $242 million associated with restructuring adjustments. If these two adjustments had not been made, Edison's average common equity balance for 2000 would have been $4.551 billion and its earned return on equity would have been 16.02%.

Edison's FERC Form 1 for the year 2000 shows that the utility recorded $266 million as amortization of regulatory debits. The notes to Edison's financial statements indicate that Edison incurred direct expenses of $67 million for the PECO merger and that the Company wrote off $23 million in goodwill associated with the merger. The sum of these reductions to Edison's income is $356 million. Adjusted for income taxes, these items had a $224 million net effect on Edison's net income. Without regulatory asset amortization, goodwill and merger costs, and without adjusting Edison's equity balance for the increased income, the return on equity becomes 20.95%. (If Edison's equity balance is increased for the added income, Edison's return on equity is 20.45%.)

Q. Why should the adjustments for regulatory amortization and merger accounting be removed in assessing Edison's financial performance?

A. First, the costs are not attributable to Edison's provision of service to customers. In addition, the rapid amortization of nuclear regulatory assets during the period when Edison's power and energy charges are cost-based allows the Company to realize high book income in the future when its rates will be market-based. Third, the merger costs will add value to shareholders in the future as savings are realized (the combined company estimates that it can realize $265 million in merger savings).

Edison has acknowledged in its SEC filings that without accounting adjustments related to merger accounting and amortization of created regulatory assets, the return on equity would have been above the earnings cap (currently the cap is approximately 14.2%):

> …increased amortization of regulatory assets may be recorded, thereby reducing the earned return on equity, ***if earnings would have exceeded the maximum allowable rate of return***"
>
> * * * *
>
> The Unicom pro forma adjustments reflecting the sale of ComEd's fossil generating plants include increased regulatory asset amortization ***because those adjustments on a prior-to merger, pro-forma basis would result in ComEd's earnings exceeding the earnings cap provision*** of the Illinois Public Utilities Act.

(Unicom 10Q from the third quarter of 2000, emphasis added.)

> Earnings for purposes of ComEd's rate cap include ComEd's net income calculated in accordance with generally accepted accounting principles and ***may include accelerated amortization of regulatory assets and amortization of goodwill.***

(Unicom 10K from 2000.)

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Thursday 1 August 2002

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Exelon reports strong earnings on favorable weather, cost savings

Exelon said Wednesday it posted a net income of $485 million, or $1.50/share, for the second quarter, up substantially from $315 million, or 98¢/share in 2001. The company also boasted increased operating income of $813 million for the quarter, compared with $792 million for the same time last year.

The company noted that improved weather-related power deliveries, lower interest expense and lower operating and maintenance costs were factors in boosting quarter earnings.

In addition, earnings benefited from the company's cost management initiative, which produced savings of $93 million in the second quarter, and about $104 million for the year-to-date, Exelon Senior Vice President and Chief Financial Officer Ruth Ann Gillis said during a teleconference Wednesday. The company's overall goal is to save roughly $200 million by the end of the year, Gillis added.

Exelon's energy delivery unit, namely Commonwealth Edison in the Midwest and Peco Energy in the mid-Atlantic, generated strong earnings, with a quarterly net income of $322 million, compared with $264 million in 2001, Gillis noted. Com Ed saw energy deliveries rise about 2.2% in the second quarter, thanks to hot weather conditions in the earlier part of the quarter, Gillis said, while Peco's energy deliveries were a bit more stable than Com Ed's due to relatively normal weather in the Mid-Atlantic region.

Operation and maintenance costs in Exelon's energy delivery sector also decreased by about $23 million, reflecting lower uncollectable accounts expense and cost management initiative savings.

The company's Exelon Generation unit also gave a strong performance with a net income of $84 million for the second quarter, compared with $71 million for the same time last year. The increase in income, the company said, was a result of lower interest expense and lower depreciation expense, but was partially offset by a trading portfolio loss of $16 million.

Exelon Enterprises, which encompasses the company's competitive retail energy sales, Energy Solutions and infrastructure services, and venture capital investments, posted a net income for the second quarter of $83 million, up significantly from a $5 million loss in 2001. However, the sector also posted a $15 million loss in operating income, only a slight improvement from a $16 million loss reported in 2001.

> *"We try to be a no-surprise company."*
>
> \- John Rowe,
> Exelon chairman and CEO

Despite the loss associated with energy trading, company Chairman and CEO John Rowe noted that considering the current industry environment Exelon saw "better than expected earnings" primarily because the company "saw problems on the horizon" and acted quickly and calmly to combat those problems.

And good earnings aside, Exelon expects low wholesale prices to continue into the second half of the year, prompting the company to further investigate opportunities for its cost management initiative, Rowe said.

Also, he noted that the current industry atmosphere has put pressure on a number of companies to shed high-value assets to boost liquidity. Exelon would cautiously approach any generation or transmission asset opportunities, he added.

"We have a new appreciation for the volatile wholesale market," Rowe said. However, the company expects to meet or exceed the $4.60/share earnings guidance for this year. In addition, Exelon expects estimated third quarter earnings to represent about 30% of full year earnings.

"We try to be a no-surprise company," Rowe commented.

Gillis explained that wholesale power prices, which have taken a nosedive as a result of the continued uncertainty in the market, are projected to remain lower than in previous years. In the Mid-America Interconnected Network, Exelon anticipates wholesale power prices to be roughly $22/MWh, while prices are expected to be $28/MWh in PJM. The average realized price excluding trading activity in the second quarter of 2002 was $31/MWh, down from $33/MWh in 2001.

Exelon "had a very good second quarter, and a good start to the third quarter," executives said. However, the company will continue its attention to detail, particularly in regards to weather, wholesale market prices and cost management initiatives.

The company also highlighted several milestones in the second quarter, including Exelon Enterprises's sale of its 49% interest in AT&T Wireless PCS of Philadelphia for an estimated $285 million; Exelon Generation's proposed acquisition of Sithe Energy Holdings for $543 million, plus the assumption of $1.15 billion of debt project; the company's exercise of options to limit the amount of capacity it receives from Midwest Generation; and Com Ed's petition to Illinois regulators to allow the company to limit the availability of bundled rates to large industrial customers. MCM

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Testimony Record

On Behalf of the Staff of the Maine Public Utilities Commission, Docket 2001-239, 2001. Evaluation of the end use and econometric sales forecast developed by Central Maine Power and preparation of an alternative sales forecast.

On Behalf of the Staff of the Maine Public Utilities Commission, Docket 2001-240, 2001. Evaluation of the sales forecast developed by Bangor Hydro Electric Company and preparation of an alternative sales forecast.

On Behalf of the City of Chicago before the Illinois Commerce Commission, 2001, Docket No. 01-0423. Direct and rebuttal testimony on the embedded and marginal cost study of Commonwealth Edison Company and the reasonableness of significant distribution expenditures made by the company.

On Behalf of Detroit Edison Company, before the Michigan Public Service Commission, Case No. U-12369. Rebuttal testimony on the valuation of customer options to switch between regulated utility service and competitive service.

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On behalf of the City of Chicago before the Illinois Commerce Commission, 1994. Docket 94-0065. Direct and rebuttal testimony of marginal cost of service and the appropriate rate design on an intra-class basis for residential customers.

On behalf of the City of Chicago before the Illinois Commerce Commission, 1993. Docket 92-0303. Direct and rebuttal testimony on the regional cost of service in the City of Chicago and the Suburban communities.

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On behalf of the Connecticut Attorney General before the Connecticut Department of Utility Control, 1984. Testimony of the prudence of Northeast Utilities in delaying construction of a nuclear plant.

On behalf of the Illinois Commerce Commission Staff before the Illinois Commerce Commission, Docket No 83-0309. Testimony on the appropriate treatment of deferred taxes after changes in the income tax rate.

On behalf of the Illinois Commerce Commission Staff before the Illinois Commerce Commission, Docket No 81-0026. Testimony on the interim and permanent phase of a rate increase proposed by Commonwealth Edison company addressing financial viability, capital structure and phase-in issues.

On behalf of the Illinois Commerce Commission Staff before the Illinois Commerce Commission, Docket No 81-0324. Testimony on the appropriate capital structure for Commonwealth Edison company from a ratepayer perspective.

On behalf of the Illinois Commerce Commission Staff before the Illinois Commerce Commission, Docket No 80-0044. Testimony on the cost of common equity capital using the discounted cash flow method for Union Electric Company.

On behalf of the Illinois Commerce Commission Staff before the Illinois Commerce Commission, Docket No 80-0167. Testimony on the Application of a variable rate of return mode to apply to Construction Work in Progress for Illinois Power Company.